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C O N F I D E N T I A L SECTION 01 OF 02 SHANGHAI 000787

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SUBJECT: NASDAQ MIGHT HAVE LOOPHOLE TO RESTRICTIONS ON OVERSEAS
LISTINGS

REF: A. SHANGHAI 769

[1](#)B. SHANGHAI 337

[1](#)C. SHANGHAI 70

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CLASSIFIED BY: Christopher Beede, Political/Economic Chief, U.S.
Consulate General Shanghai, Department of State.
REASON: 1.4 (b), (d)

[1](#)1. (C) Summary: NASDAQ China's Chief Representative believes that there might be a legal loophole to the restrictions on Chinese companies listing overseas that have been in place since September 2006. The first test of this "back door" will be in March 2008. The Ministry of Commerce is very opposed to Chinese companies listing overseas. Chinese securities brokers are also opposed and have accused the NASDAQ rep of being an imperialist-capitalist running dog. NASDAQ is working with the China Securities Regulatory Commission to help start a third stock exchange oriented towards small- and medium-sized companies. Officials at the People's Bank of China have expressed concern that they have no idea how much money is leaving China via unofficial channels and fear that this might lead to their loss of control over China's money supply. Once this money is outside of China, it is used to fund overseas investments, education, retail purchases, and savings. NASDAQ declined the USG invitation to participate in a joint representative offices opening ceremony with the NYSE, hosted by Secretary Paulson, in order to be the first overseas stock

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market to open a representative office in China. NASDAQ opened its representative office in Beijing on December 3. End summary.

NASDAQ Finds Apparent Back Door to Rule 10

[1](#)2. (C) NASDAQ China Chief Representative Guang Xunxu (strictly

protect) told Econoff on December 12 that the "Rule 10" restrictions on mergers and acquisitions, in place since September 2006 (Refs A and B), are slowing down Chinese companies who want to list on overseas stock exchanges. This slow-down, however, has not dimmed NASDAQ's prospects for 2008 as there are currently 13 companies in the listing pipeline.

13. (C) Eleven of these companies had received permission prior to September 2006 to form the special purpose vehicles (SPV) overseas that allow them to list abroad. Two of the prospective companies, however, had managed to form SPVs after the implementation of Rule 10 by exploiting a loophole in Chinese law. Guang explained that Rule 10 applies to the transfer of management control of a Chinese company to non-Chinese. It does not, however, apply to a transfer of company ownership. The "back door" that these companies have exploited is to create legal entities controlled by unnamed trustees in the British Virgin Islands or the Cayman Islands to create holding companies. These trustees then transfer their stock in the holding companies to a listing company that becomes traded over the counter. The listing company then buys the Chinese company which is then able to transfer ownership of its assets to the listing company under Chinese law. Guang said that the first test of this loophole would be in March when Beijing-based online company lists on NASDAQ.

14. (C) Prospects for new companies listing on NASDAQ beyond 2008 will depend on whether Rule 10 actually gets implemented and on whether or not the Chinese authorities move to close the loophole in the law that applies to management control, but not ownership. Overall, Guang continues to be optimistic, he emphasized.

MOFCOM Main Source of Opposition

15. (C) Guang said that the Ministry of Commerce (MOFCOM) was the Chinese Government agency most opposed to allowing Chinese companies to list overseas. His contacts at MOFCOM assert that Chinese companies were being sold too cheaply to foreigners. China Security Regulatory Commission (CSRC) opposition to

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allowing Chinese companies to list overseas was based on their desire to have more companies list in China in order to strengthen domestic markets and meet the massive investor demand for good stocks.

16. (C) Guang noted that he have been the subject of harsh criticism from Chinese securities firms and officials on the Shenzhen Stock Exchange for his role in encouraging Chinese companies to list overseas. "I've even been called an imperialist-capitalist running dog and they weren't kidding!" he exclaimed. "They are threatened by us and want to make it clear we are not welcome," he said.

17. (C) NASDAQ is providing the CSRC with technical assistance and know-how to assist with the creation of a third stock exchange to be located in Shenzhen. This exchange is to be modeled on NASDAQ and designed to give the small- and medium-sized companies that do not currently meet China's listing requirements an opportunity to go public.

Chinese: Laundering Money, Buying Stocks

18. (C) Guang, who has Chinese Government contacts and friends dating back to the 1980s and 1990s, said that the People's Bank of China (PBOC) has been very concerned with the "huge amounts" of unregulated RMB that is flowing out of China through non-official channels. The PBOC, apparently, feels that it is in danger of losing control of China's money supply. This money is being transferred out of China, largely via Hong Kong, so that mainland Chinese can finance overseas investments, their

children's overseas educations, personal purchases, and savings. Transferring money is apparently a simple process involving depositing RMB at an office in Shanghai, Shenzhen or Guangzhou and then collecting foreign exchange at an office in Hong Kong. Money can also be wired from Hong Kong to any bank account in the world, he said. On the other side of the transaction are Hong Kongese and other foreigners who are anxious to obtain RMB in China.

¶9. (C) Chinese investors in overseas stocks are mostly keen to buy Chinese stocks that are listed on stock exchanges in the United States and Hong Kong as they feel they understand the market in China and can more easily track how their investments are doing. Guang said there is even a brokerage company in New York that accepts funds "via several cutouts" from the laundering process described above and allows Chinese investors to control their portfolio from China using an internet webpage.

NASDAQ Beats NYSE In Race To Open Office, But Still Loses

¶10. (C) NASDAQ and NYSE continue their competition for pride of place in China (Ref C). Smarting from the NYSE having gotten a jump on them in receiving CSRC permission to open its representative office, NASDAQ opted out of sharing the spotlight with NYSE at the December 11 ceremony presided over by Secretary Paulson and Vice-Premier Wu Yi. Instead, Guang said, NASDAQ International made a snap decision to open their office via press conference on December 3. This allows them to claim that they were first in China.

¶11. (C) Guang saw this move as a mistake since a pre-Strategic Economic Dialogue opening ceremony with Secretary Paulson and Vice Premier Wu Yi and the other officials and dignitaries in attendance would have provided NASDAQ with "great face." This face is important to Chinese company CEOs who are considering listing overseas not always for the money involved, but also for the prestige that comes from having listed.
JARRETT